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# Line-by-Line Instructions for MI-1040 Schedule 1

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Part-year and nonresidents, complete Schedule NR (see page 39) before proceeding.

## Additions to Income

**Line 1:** Enter gross interest, dividends and income from obligations or securities of states and their political subdivisions other than Michigan. Add this income even if it comes to you through a partnership, S corporation, estate or trust. You may reduce this income by related expenses not allowed as a deduction by Section 265(a)(1) of the IRC.

**Line 2:** Enter the deduction taken for **self-employment tax** on your federal return and for other taxes on or measured by income, such as your share of city income tax paid by partnerships or S corporations, or your share of the taxes paid by an estate or trust.

**Line 3:** Use Michigan Form **MI-1040D only** if you have capital gains or losses attributable to: (1) an election to use Section 271 treatment for property acquired before October 1, 1967; (2) the sale or exchange of U.S. obligations which cannot be taxed by Michigan; or (3) the sale or exchange of property located in other states.

If you reported gains on U.S. 4797 on property acquired before October 1, 1967, or located in other states, adjust the gain on Michigan Form MI-4797.

Enter gains from the Michigan column of your MI-1040D, line 14, and MI-4797, line 18b(2). Instructions are with each form.

**Line 4:** Enter losses from a business or property located in another state which you own as a sole proprietor, a partner in a partnership, a shareholder in an S corporation or as a member of a pass-through entity. If your business is taxed by both Michigan and another state, the loss must be apportioned. Attach a *Schedule of Apportionment* (Form MI-1040H).

**Line 5:** Enter the net loss from the federal column of your Michigan MI-1040D, line 15, or MI-4797, line 18b(1).

**Line 6:** Enter the total of the following (attach a schedule if necessary):

- Add to the extent not included in AGI the amount of money withdrawn in the tax year from a Michigan Education Savings Program (MESP) account if the withdrawal was not a qualified withdrawal as provided in the MESP Act. You may first exclude any amount that represents a return of contributions for which no deduction was claimed in any prior tax year.

- Amount of net operating loss deduction (NOL carryforward) used to reduce AGI (see page 7).

- Refund received from a Michigan Education Trust (MET) contract. If you deducted the cost of a MET contract in previous years and received a refund from MET during 2005 because the MET contract was terminated, then enter the smaller of: (1) the refund you received **OR** (2) the amount of the original MET contract price (including the application and processing fees) which you deducted in previous years.

If you financed your MET contract with a MET-secured loan, deducted the cost of that contract and then defaulted on the loan, enter the amount paid in 2005 by MET to repay the portion of your defaulted loan.

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## Subtractions From Income

**Note:** Part-year and nonresidents subtract only income attributable to Michigan (column B of *Schedule NR*) on all lines except line 11.

**Line 8:** Enter income from U.S. government obligations (Series EE bonds, Treasury notes, etc.), including income from U.S. government obligations received through a partnership, S corporation or other pass-through entity. This subtraction must be reduced by related expenses used to arrive at AGI.

Investment companies that invest in U.S. obligations are permitted to pass the tax-free exemption to their shareholders.

If income from U.S. government obligations exceeds \$5,000, attach a copy of your U.S. *Schedule B* or *Schedule I* listing the amounts received and the issuing agency.

Capital gains from the sale of U.S. government obligations must be adjusted on Michigan Form MI-1040D.

**Line 9:** Enter compensation received for active duty in the U.S. Armed Forces included in AGI. Include military retirement on line 12.

**Note:** Compensation from the U.S. Public Health Service is **not** considered military pay.

**Line 10:** Enter the gains from the federal column of your Michigan Forms MI-1040D, line 14, and MI-4797, line 18b(2). See instructions for *MI-1040 Schedule 1*, line 3.

**Line 11: Income Attributable to Another State.** Nonresidents and part-year residents, complete Schedule NR. See instructions on page 40. Attach federal schedules.

Business income that is taxed by Michigan and another state must be apportioned. Complete and attach Form MI-1040H.

Capital gains from the sale of real property or tangible personal property located outside of Michigan must be adjusted on Michigan Form MI-1040D.

Michigan residents cannot subtract salaries and wages or other compensation earned outside Michigan. However, they may be entitled to a tax credit for tax imposed by governmental units outside Michigan (see pages 11-12).

Residents may subtract:

- Business income earned in other states and included in AGI, and

- Net rents and royalties from real property or tangible personal property located or used in another state.

**Line 12:** Qualifying retirement and pension benefits included in your AGI may be subtracted from income. The amount you may subtract depends on the source of the benefit. Qualifying benefits include:

- Pension plans that define eligibility for retirement and set contribution and benefit amounts in advance
- Qualified retirement plans for the self-employed
- Distributions from a 401(k) or 403(b) plan attributable to employer contributions or attributable to employee contributions to the extent they result in matching contributions by the employer
- IRA distributions received after age 59½ or described by Section 72(t)(2)(A)(iv) of the IRC (series of equal periodic payments made for life)
- Benefits from any of the previous plans received due to a disability, or as a surviving spouse if the decedent qualified for the subtraction at the time of death
- Benefits paid to a senior citizen (age 65 or older) from a retirement annuity policy that are paid for life (as opposed to a specified number of years).

You may subtract **all** pension benefits included in AGI and received from the following public sources:

- The State of Michigan
- Michigan local governmental units (e.g., Michigan counties, cities and school districts)
- Tier 2 railroad retirement
- Federal civil service
- Military retirement from the U.S. Armed Forces.

**If all retirement and pension benefits were received from public sources,** enter the total of all benefits on line 12.

**If all retirement and pension benefits were received from private sources,** enter the smaller of:

- The total of all private pensions included in AGI, or

- \$39,570 if you are a single filer, \$79,140 if you are married and filing jointly.

**If you received a combination of public and private retirement and pension benefits,** follow these steps to compute your deduction:

**Step 1:** Add all public retirement benefits included in AGI.

**Note:** If your public retirement benefits are greater than the maximum amounts (\$39,570 single filer or \$79,140 married filing jointly) you are not entitled to claim a subtraction for private pensions.

**Step 2:** If you are a single filer, deduct the amount in step 1 from \$39,570. If you are married filing jointly, deduct the amount in step 1 from \$79,140.

**Step 3:** Add all private pensions included in AGI.

**Step 4:** Determine which is smaller, the amount computed in step 2 or the amount computed in step 3.

**Step 5:** Add the amount computed in step 1 to the amount determined in step 4 and enter the total on line 12. See Example A on the back of *Schedule 1* on page 32.

**You may not subtract:**

- Amounts received from a deferred compensation plan that lets the employee set the amount to be put aside and does not set retirement age or requirements for years of service. These plans include, but are not limited to, plans under Sections 401(k), 457 and 403(b) of the IRC.
- Amounts received before the recipient could retire under the plan provisions, including amounts paid on separation, withdrawal or discontinuance of the plan.
- Amounts received as early retirement incentives, unless the incentives were paid from a pension trust.

**Line 13: Senior citizens** (age 65 or older) may subtract interest, dividends and capital gains included in AGI. This subtraction is limited to a maximum of \$8,828 on a single return or \$17,655 on a joint return. However, the maximum must be reduced by the pension

subtraction. See Example B on the back of *Schedule 1* on page 32.

**Line 14:** Enter only the taxable portion of Social Security and Tier 1 railroad benefits included on your U.S. 1040, line 20b, or your U.S. 1040A, line 14b. Do not include your total Social Security benefits.

**Line 15: Renaissance zone deduction.** To be eligible you must meet all the following requirements:

- Be a permanent resident of a renaissance zone for at least 183 consecutive days.
- Be approved at your local level.
- Must not be delinquent for any State or local taxes abated by the Renaissance Zone Act.
- Must file an MI-1040 each year.
- Have gross income of not more than \$1 million.

If you were a full-year resident of a renaissance zone, you may subtract all income earned or received. Unearned income such as capital gains may have to be prorated. If you lived in the zone at least 183 consecutive days during 2005, you may subtract the portion of income earned while a resident of the zone. If you are a part-year resident of a zone, you must complete and attach a *Schedule NR* to your MI-1040. (See “Special Note” on the back of *Schedule NR*, page 40.)

For additional information regarding qualifications for the renaissance zone deduction, call the Michigan Economic Development Corporation at (517) 373-9808.

You may also call the Michigan Tele-Help System (1-800-827-4000) and listen to topic #293.

**Line 16:** You may subtract Michigan state and city income tax refunds and homestead property tax credit refunds that were included in AGI.

**Note to farmers:** You may subtract (to the extent included in AGI) the amount that your State or city income tax refund and homestead property tax credit exceeds the business portion of your homestead property tax credit.

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**Line 17: Michigan Education Savings Program.** You may deduct, to the extent not deducted in calculating AGI, the total of all contributions less qualified withdrawals made during 2005 by the taxpayer in the tax year to accounts established through the MESP. The deduction may not exceed \$5,000 for a single return or \$10,000 for a joint return per tax year. There are numerous education savings accounts available from other states and investment companies, but Michigan only allows a tax deduction for contributions to accounts established through MESP.

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**Line 18: Michigan Education Trust.** You may deduct the following:

- If you purchased a MET contract during 2005, you may deduct the total contract price (including the processing fee).
- If you purchased a MET payroll deduction or monthly purchase contract, you may deduct the amount paid on that contract during 2005 (not including fees for late payments or insufficient funds). You should receive an annual statement from MET specifying this amount.
- If you purchased a MET contract between 1988 and 1990 with a MET-secured loan and have not deducted the total contract price, you may deduct the principal amount paid on the secured loan during 2005.
- The amount included in AGI as income to the purchaser because the MET contract was terminated.

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**Line 19: Miscellaneous subtractions** include:

- Any part of a qualified withdrawal from an MESP account included in AGI.
- Contributions to national or Michigan political parties or candidates. The maximum deduction is \$50 on a single return and \$100 on a joint return.
- Benefits from a discriminatory self-insured medical expense reimbursement plan, to the extent these reimbursements are included in AGI.
- Proceeds and prizes included in AGI won in State of Michigan regulated bingo, raffle or charity games.
- Amount of salary and wage expense that cannot be deducted on your federal return because you are claiming a work opportunity credit, clinical testing (orphan drug) credit or research credit. Attach a copy of U.S. *Work Opportunity Credit* (Form 5884), *Credit for Increasing Research Activities* (Form 6765) or *Orphan Drug Credit* (Form 8820) to substantiate this subtraction.
- Losses from the disposal of property reported in the Michigan column of Michigan Form MI-1040D, line 15 or Form MI-4797, line 18b(1).
- Amount used to determine the credit for elderly or totally and permanently disabled from U.S. *1040 Schedule R*, line 19, or U.S. *1040A Schedule 3*, line 19.
- Michigan net operating loss deduction. Attach Form MI-1045. See page 7.
- Gross income included in AGI from Michigan gas and oil royalty interest or working interest.

- The amount of a distribution from individual retirement accounts that qualify under section 408 of the IRC if the distribution is used to pay qualified higher education expenses (tuition, books, fees, etc.) at a postsecondary educational institution.
- Holocaust victim payments.
- Distribution from a pension or retirement plan that is contributed to a qualifying charitable organization. To qualify, you must make the payment to the charity within 60 days of receiving the distribution, and reduce the amount of the contribution by any pension subtraction taken and two times the total amount of credits claimed for a public contribution credit, homeless shelter/food bank credit and the community foundation credit.

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**You may not subtract:**

- Itemized deductions from U.S. *Schedule A*.
  - Sick pay, disability benefits and wage continuation benefits paid to you by your employer or by an insurance company under contract with your employer.
  - Unemployment benefits included in AGI, except railroad unemployment benefits.
  - Distributions from a deferred compensation plan received while a resident of Michigan.
  - Lottery winnings. (Exception: installment payments from prizes won on or before December 30, 1988 may be subtracted.)
- Note:** Include your installment gross winnings as reported on your W-2G form, box 1, and show on your Schedule W, Table 1, in the appropriate box.